

Service Date: September 21, 1982

DEPARTMENT OF PUBLIC SERVICE REGULATION  
BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MONTANA

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IN THE MATTER of the Application of       )  
the City of Lewistown to Increase Water    )  
Rates and to Modify Rules and Regulations. )

UTILITY DIVISION  
DOCKET NO. 82.3.12  
ORDER NO. 4937

APPEARANCES

FOR THE APPLICANT:

Robert Knopp, City Attorney, City Hall, Lewistown, Montana 59457

FOR THE INTERVENORS:

John Allen, Staff Attorney, Montana Consumer Counsel, 34 West Sixth Avenue, Helena, Montana 59620.

FOR THE COMMISSION:

Eileen Shore, Chief Legal Counsel, 1227 11th Avenue, Helena, Montana 59620.

BEFORE:

HOWARD L. ELLIS, Commissioner and Hearing Examiner.

FINDINGS OF FACT

1. On March 2, 1982, the City of Lewistown (Applicant or City) filed an application with this Commission for authority to increase rates and charges for water service to its customers in Lewistown, Montana. The Applicant requested an average increase of approximately 71 percent which would result in an increase of approximately \$104,000 in annual revenues. The Applicant also requested modification of certain rules and regulations of the water utility.

2. On June 22, 1982, pursuant to notice of public hearing, a hearing was held in the City Council Chambers, Civic Center, Lewistown, Montana. The purpose of the public hearing was to consider the merits of the Applicant's proposed water rate adjustments. At the close of the hearing, all parties waived their rights to a proposed order and stipulated to authorize the Commission to issue a final order in this Docket. 2-4-622 (2), MCA.

3. At the public hearing, the Applicant presented the testimony and exhibits of:

Wilber E. Lindstrand, Mayor of Lewistown  
Thomas Evans, City Engineer  
J. Jay Billmayer, Consulting Engineer

These witnesses testified relative to: the need for capital improvements in progress, the financial requirements of the revenue bond issued to pay for the capital improvements in progress, the increases experienced in operation and maintenance expense, rate structure, the need to modify certain rules and regulations of the water utility, and the request to establish a reserve account in which funds would be accumulated to offset a portion of the future expense of replacing the transmission line from Giant Springs to the City.

4. The Montana Consumer Counsel at the public hearing presented the testimony of one public witness. The public testimony from said witness indicated full agreement with the City's proposal.

#### CAPITAL IMPROVEMENT PROGRAM

5. The City in its application set forth a two phase capital improvement program; the first phase of the capital improvement program is designed to correct and improve deficiencies existing in the water distribution system, phase two of the capital improvement program is the replacement of the transmission line connecting the water supply source, Giant Springs, with the City's water distribution system.

6. Phase one of the capital improvement program was under construction at the time of the public hearing and has been funded from a Revenue Bond Issue in the amount of \$300,000, having a term of 20 years, with interest payable at the rate of 12.5 to 14.0 percent per annum and the requirement that the City provide a debt service coverage of 125 percent of the maximum amount of annual principal and interest payable. The City accomplished the funding of phase one of the capital improvement program by increasing its annual revenue to the annualized

level of \$164,687 ( $\$147,042 \times 1.12 = \$164,687$ ). In doing so, the City followed the procedures outlined in Title 69, Chapter 7, MCA which allows municipalities the authority to increase annual revenues by 12 percent without Public Service Commission authorization, therefore, the Commission finds it unnecessary to consider the phase one capital improvements or their financing.

7. Phase two of the capital improvement program is the replacement of the transmission line extending from Giant Springs, the City's water supply source, to the City's distribution system. The City has proposed that they be allowed to accumulate \$63,000 annually, in a reserve fund, to defray a portion of the anticipated construction costs of this line, thereby reducing the amount of future bonded indebtedness. The City's proposed financing mechanism is unique and therefore requires discussion before the Commission makes a finding relative to its propriety.

8. The City, at the public hearing, indicated that within the next ten years it will be necessary to replace the transmission lines connecting Big Springs with the City distribution system. Therefore, the City has proposed that it be allowed to accumulate a \$1 million reserve fund to be used solely for the restoration or reconstruction of the transmission line and attendant facilities. The \$1 million reserve fund is to be generated from the current operating revenues of the utility at the rate of \$63,000 annually, and placed in an "earmarked" account that would result, with interest, in a \$1,000,000 reserve at the end of ten years. It is the City's position, given the following facts, that the City should be allowed to accumulate a reserve fund as outlined:

the present transmission line along with the major portion of the distribution system have been totally paid off for a period of 30 years; the proposed improvement will not expand or improve service, only continue it at the present level; the establishment of a reserve fund will minimize the amount of increase necessary when construction is commenced; and the current system users are not and have not been assessed for major capital improvement costs for a substantial period.

9. Basically the City is requesting that the Commission allow the current ratepayer to subsidize the future ratepayer, through the establishment of this reserve account, i.e. the current ratepayer is contributing funds toward the cost of constructing the new transmission line while receiving no current benefit and thereby reducing the rates future ratepayers will be assessed. It

has long been this Commission's policy that the customer receiving the benefit of a major capital improvement should pay for the improvement. The Commission, in its Order No. 4824, a City of Bozeman rate increase request, discussed matching of benefit received by the consumer with the cost of providing the benefit. The following quote from that Order concisely states this

Commission's position relative to matching benefits and expenses:

Generally, the issuance of tax-exempt bonds to be repaid over the useful life of a public improvement is the most equitable and cost effective way to pay for such improvements. It is equitable because it permits those who benefit from the use of the improvements during the entire useful life of the improvements, to pay their share of the cost of the improvements. If all system improvements were to be paid for on a pay-as-you-go basis, rather than through a long-term bond issue, only the initial user would pay the costs of the improvement, providing a "free ride" for later users. Issuing tax-exempt bonds is cost effective because interest rates are lower, thus reducing borrowing costs that must be paid by users of the water system. Also, since inflation reduces the value of the dollar, the loan will be paid back with "cheaper" dollars, if we continue to experience inflation.

Based upon the foregoing, the Commission finds the City's request to establish a reserve fund inequitable and therefore denies the request for \$63,000 annually to be placed into this reserve.

10. It should also be pointed out that the City has in its surplus reserve between \$320,000 and \$365,000 which is invested. That surplus, as well as the interest received on it, will be available to assist in the financing of the transmission line construction when the City undertakes the replacement.

#### OPERATION AND MAINTENANCE EXPENSE

11. The test year in this case is the fiscal year ending June 30, 1981 adjusted for annual inflation. The Commission finds the test year adjusted for inflation to be a reasonable period within which to measure expenses for the purpose of determining a fair and reasonable level of rates and accepts the City's projection that operation and maintenance expense will be \$130,768 (\$102,508 expenses and \$28,260 renewals or recurring annual capital improvements).

DEBT SERVICE

12. The Applicant has a current outstanding revenue bond with the requirement that the net operating revenues of the utility must equal at least 125 percent of the maximum amount of the principal and interest payable in any subsequent fiscal year. The City has calculated that to meet this requirement of the bond indenture the net revenues of the utility must be \$57,600. This calculation meets the requirement of the bond indenture and is therefore accepted by the Commission.

13. Under the present bond ordinance, the City is required to have Net Operating Income of at least \$57,600 to meet the 125 percent coverage ratio. To determine Net Operating Income, operation and maintenance expense is subtracted from the total revenues of the utility. As was indicated in Finding of Fact No. 11, the Commission has accepted operation and maintenance expense totaling \$102,508.

REVENUE NEED

14. The following calculation is the Commission's finding relative to the water utility's revenue need:

Current Water Revenues	\$164,687
Projected Operation and Maintenance	<u>\$102,508</u>
Net Operating Income	\$ 62,179
Required Net Operating Income	\$ 57,600
Revenue Deficiency	-0-

The Commission finds that the utility should be authorized no increase in revenues since it currently meets the requirements of its bond ordinance.

RATE STRUCTURE

15. The City presented a traditional cost-of-service study utilizing the base-extra capacity method. In the base-extra capacity method all costs are separated into components of base costs, extra capacity cost and customer cost.

16. In the base-extra capacity cost allocation, each component of the water system's

capital cost and operating costs relating to demand is assigned to a demand criteria (average annual consumption, maximum day demand or maximum hour demand) through the utilization of a linear equation. Customer costs are assigned directly since they are incurred irrespective of the amount of water used.

17. In the cost-of-service study submitted by the Applicant, the Applicant has assigned costs as previously outlined to two user categories, residential and commercial. It is the Commission's opinion that the Applicant should revise the cost of service study to include a third category of user, namely fire protection. There are capital costs and operating costs associated with the provision of fire protection by a water utility; these costs would include, in part, purchase of fire hydrants, maintenance of hydrants and sizing of mains to insure adequate fire flows, etc. This charge should be assessed on a per hydrant basis and billed to the City (exclusive of private fire protection) so that they may implement a tax and recover this from the property owner.

18. In its cost-of-service study the Applicant has indicated that maximum hour demand for the City was 8.31 million gallons of which 100 percent was assigned to residential consumption. The commercial user is a consumer during maximum hour demand and therefore the Commission finds that the Applicant should assign the commercial class its representative volume of use during maximum hour demand.

### CONSUMPTION

19. The Applicant has utilized total water input into the system minus the metered residential and commercial consumption (per City's meter reading records) to determine annual consumption of the unmetered residential consumer. This calculation allocates all of the "loss and unaccounted for water" to the unmetered residential class. The Commission finds this to be an inappropriate method of calculating consumption for the customer classes because "loss and unaccounted for water" is a factor attributable to all customer classes.

20. The City testified that a 10 percent "loss and unaccounted" for factor would be reasonable for the Lewistown water utility. The Commission finds that the Applicant should allocate a 10 percent "loss and unaccounted" for factor to each user classification.

RULES AND REGULATIONS

21. The City in its application requested authorization to amend certain rules and regulations under which the utility operates. The Commission makes no finding regarding these changes in view of the fact that the 1981 Legislature passed legislation allowing municipal utilities to adopt service rules and regulations without this Commission's approval (Title 69, Chapter 7, MCA).

CONCLUSIONS OF LAW

1. The Montana Public Service Commission properly exercises jurisdiction over the subject matter and parties in this proceeding.
2. The Commission afforded all interested persons notice and an opportunity to participate in these proceedings.
3. The rates approved herein are reasonable and just.

ORDER

NOW THEREFORE, at a session of the Public Service Commission, Department of Public Service Regulation of the State of Montana, held in its offices 1227 11th Avenue, Helena, Montana, on the 20th day of September, 1982, there being present a quorum of commissioners there came regularly before the Commission for final action the matters and things in Docket No. 82.3.12, and the Commission being fully advised in the premises;

IT IS ORDERED by the Commission that the City of Lewistown shall file tariffs, consistent with the Findings of Fact herein, generating no increase in annual revenues.

IT IS FURTHER ORDERED that the rates approved herein shall not become effective until the tariffs and necessary calculations have been submitted and approved by this Commission.

IT IS FURTHER ORDERED that a full, true and correct copy of this Order be sent forthwith by first class United States mail to the Applicant and all other appearances herein.

DONE IN OPEN SESSION this 20th day of September, 1982, by a vote of 4 - 0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

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GORDON E. BOLLINGER, Chairman

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HOWARD L. ELLIS, Commissioner

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CLYDE JARVIS, Commissioner

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THOMAS J. SCHNEIDER, Commissioner

ATTEST:

Madeline L. Cottrill  
Commission Secretary

(SEAL)

NOTE: You may be entitled to judicial review of the final decision in this matter. If no Motion for Reconsideration is filed, judicial review may be obtained by filing a petition for review within thirty (30) days from the service of this order. If a Motion for Reconsideration is filed, a Commission order is final for purpose of appeal upon the entry of a ruling on that motion, or upon the passage of ten (10) days following the filing of that motion. cf. the Montana Administrative Procedure Act, esp. Sec. 2-4-702, MCA; and Commission Rules of Practice and Procedure, esp. 38.2.4806 ARM.